FINANCIAL SERVICES/Operating Subsidiaries

SUBJECT: **Financial Services Modernization Act of 1999 . . . S. 900. Gramm motion to table the Shelby/Daschle amendment No. 315.**

ACTION: MOTION TO TABLE AGREED TO, 53-46

SYNOPSIS: As reported, S. 900, the Financial Services Modernization Act of 1999, will reform Depression-era laws in order to eliminate barriers that prevent banks, insurance companies, and securities firms from affiliating. The bill will create a new statutory framework for the financial services industry that will increase its safety and soundness and that will give consumers more choices and lower prices.

The Shelby/Daschle amendment would permit all but the largest banks to engage in insurance and securities activities through operating subsidiaries rather than through bank holding company affiliates. Any such operating subsidiaries would have to meet the same safety and soundness protections and lending restrictions that the Federal Reserve imposes on foreign banks which are permitted to operate securities subsidiaries in the United States. Further, a bank would have to deduct its entire equity investment in its subsidiary from its own capital and still remain well capitalized, and it would not make (without prior approval) an equity investment in a subsidiary if that investment, when made, would exceed the amount that the bank could pay as a dividend without prior regulatory approval. Functional regulation would be retained.

Debate was limited by unanimous consent. After debate, Senator Gramm moved to table the amendment. Generally, those favoring the motion to table opposed the amendment; those opposing the motion to table favored the amendment.

Those favoring the motion to table contended:

This amendment would permit banks to open operating subsidiaries to provide insurance and securities services instead of requiring them to provide those services through bank holding company affiliates. This change is so immense, and so dangerous,

(See other side)

YEAS (53)

Republicans (47 or 87%)		Democrats (6 or 13%)
Abraham	Jeffords	Byrd
Allard	Kyl	Dorgan
Ashcroft	Lott	Feingold
Bond	Lugar	Moynihan
Brownback	Mack	Schumer
Bunning	McCain	Wellstone
Burns	McConnell	
Chafee	Murkowski	
Collins	Nickles	
Coverdell	Roberts	
Craig	Roth	
Crapo	Santorum	
DeWine	Sessions	
Domenici	Smith, Bob	
Enzi	Smith, Gordon	
Frist	Snowe	
Gorton	Specter	
Gramm	Stevens	
Grassley	Thomas	
Gregg	Thompson	
Helms	Thurmond	
Hutchinson	Voinovich	
Hutchison	Warner	
Inhofe		

NAYS (46)

Republicans (7 or 13%)	Democrats (39 or 87%)	
Bennett	Akaka	Kennedy
Campbell	Baucus	Kerrey
Cochran	Bayh	Kerry
Grams	Biden	Kohl
Hagel	Bingaman	Landrieu
Hatch	Boxer	Lautenberg
Shelby	Breaux	Leahy
	Bryan	Levin
	Cleland	Lieberman
	Conrad	Lincoln
	Daschle	Mikulski
	Dodd	Murray
	Durbin	Reed
	Edwards	Reid
	Feinstein	Robb
	Graham	Rockefeller
	Harkin	Sarbanes
	Hollings	Torricelli
	Inouye	Wyden
	Johnson	

NOT VOTING (0)

Republicans (0)	Democrats (0)

VOTING PRESENT (1)
Fitzgerald

EXPLANATION OF ABSENCE:
1—Official Business
2—Necessarily Absent
3—Illness
4—Other

SYMBOLS:
AY—Announced Yea
AN—Announced Nay
PY—Paired Yea
PN—Paired Nay

that it would be much better to enact no reform at all than to approve it. It would lead to the repoliticization of monetary policy and to huge concentrations of wealth, with little competition, in the financial services industry. Mid-size banks are lobbying for this change, and they would benefit in the short-term if it were enacted, but they would be cutting their own throats in the long-term.

The issue should not be partisan, and it has not been in the past. Unfortunately, this year the Clinton Administration decided to press for this change in a blatant effort to rest control of monetary policy from the independent Federal Reserve. Most Democrats in both the Senate and the House, despite reservations we know many of them have, will obediently follow his lead on this vote. Some Democrats, though, feel so strongly they will oppose their party leader by voting to table. On the Republican side, we expect that most Members will vote to table on policy grounds, but not all will because some Republican Senators support allowing subsidiaries. They view it as a matter of treating mid-size banks fairly. They note that large banks already have holding companies and, thus, would be spared the expense of having to create them, and they note that this bill contains an exemption for small banks (which cannot afford the expense of creating holding companies and which control too small a percentage of banking assets to cause much market distortion). This argument is valid, but we think that, in the long-term, mid-size banks would be cutting their own throats. They should take the cost of setting up holding companies now rather than risk monetary policy being taken over by politicians.

Bank holding companies are companies that own banks. Most bank assets are in banks that are owned by bank holding companies. Bank holding companies are regulated by the Federal Reserve. The Federal Reserve is set up to be independent of political pressure. To put it in succinct, though very general, terms, its purpose is to make certain that the value of money remains stable. A stable money supply makes long-term investments and planning possible, which lead to economic growth, income growth, and new jobs. The Federal Reserve was created in the early part of this century after decades of political manipulation of monetary policy had led to numerous "boom and bust" (rapid growth and inflation followed by depression) cycles. Banks themselves are under regulation by the Treasury Department, which is under the control of political appointees. Banking policy, though, has primarily been set through Federal Reserve regulation of holding companies.

If banks were allowed to open operating subsidiaries to provide insurance and securities services, as proposed by the Sarbanes amendment, we believe that most of them would exercise that option because it would give them an immediate financial benefit. The Federal Reserve estimates that such banks would have a 14-basis point (.14 percent) advantage over bank holding companies that opened affiliates. In banking, a 14-basis point advantage is huge. Our colleagues have said that they do not fear this advantage because foreign banks, which have subsidies from their own countries, have been allowed to sell securities in the United States and they have not been able to gain a competitive advantage. What our colleagues overlook is that most foreign banks are poorly run. We are not surprised that they have been unable to transfer the advantage of their subsidies to their subsidiaries--they have a hard enough time making profits in their regular banking activities. American banks are better run. They would know how to use a 14-basis point advantage.

Holding companies would become obsolete as assets were shifted to take advantage of the option of using subsidiaries. As a result, the Treasury Department would soon become the main regulator of the banking industry, and would end up determining a large part of monetary policy. We respect the current Secretary of the Treasury, but he will not be in that post forever, and we note that the Treasury Department is always led by political appointees and is always subject to political pressure. When it was possible in the past for politicians to manipulate monetary policy for short-term gains, they did, and we believe they would do so again if they had the chance. For that reason alone we would vote against allowing operating subsidiaries.

However, that huge danger is not the only danger that would come from allowing the formation of operating subsidiaries. It would also encourage economic concentration rather than competition. Banks that had insurance and security companies would have access to deposit insurance, the Federal Reserve Window, and the Reserve Wire, and that access would give them an unfair competitive advantage. As a result, we believe that most insurance and securities activities would gradually come under the control of banks. Consumers would then be left with fewer choices and higher prices. Yet another problem is that it would increase the risk for deposit insurance. Some of our colleagues like to imagine that a bank that had an insurance company that failed could be insulated from that loss, but that if the bank failed the Government could sell off the insurance company to cover deposit insurance losses. We think that the more likely result is that some banks would get involved in these other activities before they had enough competence, would suffer losses, and the taxpayers, through insurance, would end up footing the bill. On the other side, under a holding company structure, deposits will not be risked. The bank will be operated totally apart from any insurance or securities businesses, so its assets will be much more insulated.

We understand and sympathize with our colleagues' concern for mid-size banks. This bill is going to put them on an unequal footing, at least initially, with larger banks. However, their proposed solution to this problem is exceedingly dangerous for all of the reasons outlined above. We therefore strongly urge our colleagues to defeat this amendment. If it is not tabled, we will pull the bill.

Those opposing the motion to table contended:

The bill before us will do a lot for the big money-center banks in New York, London, and Hong Kong. A lot of those changes will help the American economy overall, and we are generally supportive of them. However, this bill contains nearly nothing for main-street America banking. Community and regional banks' needs are overlooked, and, in the process, those banks are going to be put at risk of having their markets taken over by newly strengthened mega-banks.

As this bill is drafted, by far its worst feature is that it will require regional and mid-size banks to form holding companies in order to provide insurance and securities services. No one in this debate has disputed that the formation of such companies is an expensive matter. For large banks, this requirement is an irrelevancy because they already have holding companies, and for small banks it is not an issue because they will be given an exemption under this bill so they can provide those services through subsidiaries rather than through holding company affiliates. For mid-size banks, though, which do not now have holding companies and which will not be given an exemption, this requirement will cause a huge competitive disadvantage. The Shelby amendment would fix this problem simply by allowing all but the very largest banks to provide insurance and securities services through subsidiaries rather than through holding company affiliates.

The first objection of our colleagues is that this amendment would give a competitive advantage to banks that operated subsidiaries. They have put forward good theoretical arguments in support of that objection, and they have the backing of the Federal Reserve for those arguments. We have experience on our side, though. Large foreign banks with total assets in excess of $450 billion have already been given permission to engage in securities activities in the United States through operating subsidiaries instead of through holding company affiliates. These foreign banks, according to the Federal Reserve, have the advantage of large home-country subsidies, but they have not been able to gain any comparative advantage in their United States securities trading because they have not been able to transfer the value of those subsidies to their subsidiaries. As the Federal Reserve put it, the subsidies have not "traveled well." Our colleagues theory is thus really just an assumption that flies in the face of all evidence.

Our colleagues next concern is that operating subsidiaries would be regulated by the Treasury Department. We do not share that concern. Any bank that objected to Treasury Department regulation could simply form a holding company and start affiliates for its insurance and securities activities. That action would put its activities under Federal Reserve regulation. Under the Shelby amendment, there would be competition among regulators; we believe that would promote better regulation than the monopoly situation favored by our colleagues.

The final argument against this amendment is that it would put deposit insurance at greater risk. We disagree, as do the current and former chairmen of the Federal Deposit Insurance Corporation. The Shelby amendment would strengthen deposit insurance, because, if a bank were to fail, the Government could take profits from the insurance and securities companies or could sell those companies to help cover losses. Under a holding company structure, the profits do not go to the bank but to the holding company, so those profits could not be used to cover bank losses.

The arguments in favor of and in opposition to this amendment are complex, and Senators on both sides have very strong opinions as to the correct course to follow. We are convinced that this amendment is necessary to correct a strong bias in this bill against mid-size banks. If we do not adopt it, those banks will be weakened, and an even larger percentage of this country's banking assets will end up concentrated in a few giant banks. We should not allow that result. We urge our colleagues to oppose the motion to table.